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No. 440

Supreme Court of the United States

OCTOBER TERM, 1947

JOHN A. LAIRD, PETITIONER

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI TO THE SECOND CIRCUIT COURT OF APPEALS

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This is a petition for a writ of certiorari to the Second Circuit Court of Appeals to review a decision (CHASE and CLARK, *CJJ.*, and RIFKIND, *DJ.*) affirming a judgment in the Southern District of New York (CONGER, *DJ.*) in favor of the defendants.

Petitioner, one of approximately 1,000 pre-organization purchasers of "when issued" stock of respondent United, sued on its derivation to recover for it $440,000 damages for deceit practiced by the other respondents under circumstances of aggravated corporate abuse set forth in the statement of facts. In this diversity suit, the District Court ignored the state rule that such deceit operates as an actionable injury to the corporation. Instead, the District Court applied a rule of pre-*Erie* federal common law that such deceit does not defraud the corporation and dismissed the complaint.

The Circuit Court of Appeals affirmed the holding of the District Court, under the "federal" rule, that

the complaint did not show fraud on the corporation. Any residual cause of action, for breach of fiduciary duty, held the court, would be barred by the state statute of limitations applicable to a cause of action of the last mentioned type.

In the state court the suit, sounding in deceit and commenced within a few months after petitioner's discovery of the facts, would have been timely.

QUESTIONS PRESENTED

1. Whether under *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64, and *Guaranty Trust Co.* v. *York*, 326 U. S. 99, a federal court may in a diversity suit ignore state law pursuant to which the pre-organization purchasers of when issued stock from promoters or bankers to whom it has been optioned are deemed original stockholders, so that deceit practiced on such purchasers constitutes fraud on the corporation.

2. Whether the court may hold that a complaint alleging such facts states only a case of breach of fiduciary duty, barred by the shorter statute of limitations applicable to a wrong of that kind.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals is reported at 163 F. (2d) 12. The opinion of the District Court, unreported, appears at pages 1230-1250 of the record.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 13, 1947 (R. 1280). The jurisdiction of

this court is invoked under § 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF FACTS

Respondents Powell and Rogers, with the assistance of the respondent The Chase, promoted United (R. 48-54, 118-122, 250), a New York corporation (R. 622), to acquire and combine six shipyards (R. 595-662, 779-87), including the properties of W. & A. Fletcher Co., in receivership (R. 727), which company owed The Chase over $700,000 (R. 874). To raise from the investing public the $9,000,000 necessary for the promotion, United, controlled by Powell and Rogers (R. 118-119), optioned (R. 1277) 450,000 shares of common stock (R. 707-13) to Albert H. Wiggin, chairman of the board of The Chase (R. 441), John E. Aldred and Richard F. Hoyt of Hayden, Stone & Co. (R. 183) through whom the shares were publicly offered (R. 743, 158). Prior to the offering, a syndicate (R. 747-8) formed by the bankers (R. 158) agreed with the bankers, but not with United, to take the shares if the bankers should exercise their option (R. 719-22).

The offering was made on a fraudulent prospectus (R. 711-13) which made it appear (R. 505-6) that options on the six properties were held by United and that the aggregate purchase price of $20,090,000 in cash and securities was to go to the named vendors, whereas in fact (1) the options on four of the properties were held by Powell and Rogers (R. 618-22, 636-51, 770-4, 121-2) and (2) the $20,090,000 included $440,000 in preferred stock to be received by Powell and Rogers as a bonus for participating in the financing to the extent of

$1,700,000 (R. 639, 649), which sum was loaned to them for the purpose by The Chase (R. 848). Powell, Rogers and Wiggin had knowledge of the prospectus and that it was to be used on the offering and Rogers approved it as attorney for United (R. 701, 710, 106, 134-5); and the bankers, including Wiggin, knew and approved of the bonus to be received by Powell and Rogers (R. 127, 137, 1237-8). Powell and Rogers admitted that no information regarding their receipt of the $440,000 par value of preferred stock was ever conveyed to the purchasers on the public offering (R. 106-8, 135-9).

The offering was oversubscribed (R. 1233, 536, 552-3), the entire issue being bought up by over 1,000 investors (919-20, 918), including your petitioner, who, induced by and in reliance on the prospectus and believing therefrom that United held the options and entirely unaware of the secret profits of the promoters (R. 477, 505-6), purchased 100 shares for $2,200 on January 15, 1929 (R. 753), the day of the offering (R. 413). On similar inducements (R. 538-40, 548-9, 591) another investor, Baker-Scott Corporation, since dissolved (R. 534), became a member of the syndicate (R. 722) and purchased 31,000 shares for $682,000 (R. 765-8), its subscription having been materially cut by the syndicate managers (R. 536, 719, 552-3).

On January 21, 1929, the selling price of the stock was collected (R. 164-5, 745) from your petitioner (R. 754, 759-60), from Baker-Scott (R. 177) and from the other purchasers, in exchange for interim receipts of The Chase (R. 755-6, 762, 764-5). Under these receipts, The Chase agreed to hold the fund for the security of the receipt holders, to pay out of it $9,000,000 to United in exchange for the 450,000 shares and the balance of

$900,000 to the bankers for their profit, and on surrender of the receipts, to distribute the stock, or if the deal should not go through, to refund the subscription money (R. 715-18, 755). Under date of January 15, 1929 the bankers had ordered United, subject to exercise of the option, to deliver the 450,000 shares to The Chase as depositary under the interim receipt agreement (R. 830).

The closing took place on February 28, 1929 at the offices of The Chase Securities Corporation (R. 222-3). Up to that time, the option on the 450,000 shares had not been exercised. Now, however, The Chase, from the deposited funds, paid the $9,000,000 to United out of which sum, United's entire cash capital (R. 712), the six properties were acquired (R. 894) and United issued the 450,000 shares to The Chase as depositary as aforesaid (R. 1234, 830-833).

At the closing, Powell and Rogers borrowed the $1,700,000 from The Chase in its capacity as a commercial bank (R. 848), participated in the financing and received their bonus of $440,000 par value of preferred stock (R. 143, 834), worth on that date at least $440,000 (R. 774, 824-5).[1]

Instead of immediately offering to deliver the 450,000 shares to your petitioner and to the other interim receipt holders as it was obliged to do (717, 755), The Chase, on an indemnity agreement signed by Rogers as secretary of United (R. 881-3), held the stock

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[1] This was in addition to the $60,000 cash which Powell and Rogers received from the corporation to cover their promotional and legal services (R. 124-5) and $34,895.80 received by them as participants in the banking syndicates and selling group (R. 748, 752).

from February 28th until April 17th (R. 941-5), in the meantime giving to the promoters a proxy (R. 928) thereon which Rogers, general counsel for United (R. 120, 122), used at a meeting of "stockholders" held April 3, 1929, to vote the stock in favor of a resolution ratifying the promoters' bonus (R. 939-40, 261-2). This meeting was held without notice to your petitioner or to any of the other interim receipt holders (R. 925, 833-4, 262-4).

A few months after discovering the facts (R. 513), in 1940, and after an unsuccessful attempt to obtain an audit of the transactions between the management (Rogers, president) and the corporation (R. 1226-8), your petitioner, an attorney and counsellor of New Jersey (R. 477, 512), commenced this suit in the Southern District of New York, alleging diversity of citizenship as the basis of the jurisdiction of the court as a federal court (R. 4, 46.12).

Deceit was specifically alleged in the terms referred to in *Reno* v. *Bull*, 226 N. Y. 546, 550, *viz.*, (1) representation and falsity in the prospectus, (2) *scienter* by the defendants, (3) deception of the purchasers in general and of petitioner and of Baker-Scott Corp. in particular, and (4) injury in that the $440,000 par value of preferred stock was issued to Powell and Rogers without consideration (amended complaint, paragraphs 10, 39-42, 44-56, 62, 63(d), 71, 72; R. 46.15-16, 46.25-30, 46.33-35).

During the trial, the District Judge thus stated the issue (R. 131):

> "It is not a question of defrauding these two plaintiffs in the sale of stock * * *
>
> The real issue is whether or not the corporation was defrauded, * * *."

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

(1) In failing to hold that the original holders of the 450,000 shares were petitioner and the other holders of the interim receipts at the time of the closing on February 28, 1929.

(2) In failing to hold that the deceit practiced on petitioner and on the other holders of the interim receipts at the time of the closing on February 28, 1929 constituted deceit on United.

(3) In failing to hold that the suit, having been commenced less than six years after petitioner's discovery of the facts, was not barred by limitation.

(4) In holding that the original holders of the 450,000 shares were the bankers.

(5) In holding that at the time of the closing, all parties then having an interest in United were fully aware of all the facts.

(6) In holding that the cause of action asserted by petitioner was a cause of action for breach of fiduciary duty to United.

(7) In holding that the suit was barred by the New York statute of limitations.

REASONS FOR GRANTING THE WRIT

In clear contravention of the doctrine of *Erie Railroad Co.* v. *Tompkins, supra,* the decision below frustrates the salutary rule of state common law that a corporation suffers actionable wrong when the pre-organization purchasers of its stock are deceived by promoters or bankers who sell the shares "when issued". Un-

der the so-called "federal" rule, disapproved by this Court in *McCandless* v. *Furland*, 296 U. S. 140, but nevertheless applied in the decision below, the corporation may not recover, however gross the fraud.

That deceit practiced in securing subscriptions to the original capital of a corporation constitutes deceit in its organization, for which the corporation may recover, has been recognized by both state and federal courts. See, *e.g.*, *Colton Improvement Co.* v. *Richter*, 26 Misc. 26; *Crowe* v. *Malba Land Co.*, 76 Misc. 676; *Davis* v. *Las Ovas Co.*, 227 U. S. 80.[2] But where as here such capital is raised by optioning its original stock to bankers, who prior to organization of the corporation sell the shares "when issued"—that is to say, sell their option right to receive the stock on its original issuance, a conflict of authority obtains as to whether the corporation is bound by the bankers' consent to promoters' profits concealed from the purchasers.

In 1923 the Second Circuit Court of Appeals laid down the rule that the corporation is so bound in *Ball* v. *Bond, Elliott & Harrison*, 294 Fed. 227,[3] which case

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[2] If all of the stockholders agree to the basis of organization, however inflated, subsequent purchasers of the stock from the incorporators cannot successfully contend that the corporation was deceived by what the organizers agreed to. *Blum* v. *Whitney*, 185 N. Y. 232; *Seymour* v. *Spring Forest Cemetery Ass'n*, 144 N. Y. 333, 340.

[3] "Appellant puts forward the theory that, because of the dealings with the syndicate and the dealings of members of the syndicate with the public prior to incorporation, therefore both the public and the syndicate members were equitable stockholders at the time of the transactions complained of. This theory is characterized by ingenuity rather than by substance, and in our view does not invite discussion." (294 Fed. pp. 232-3; *cert.* den. 264 U. S. 584)

was followed in the Third and Seventh Circuits in *South Penn Collieries Co.* v. *Sproul,* 52 F. (2d) 557, 559-60 and *Ball* v. *Chapman,* 1 F. (2d) 895, respectively, and reaffirmed by the Second Circuit in *McCandless* v. *Furlaud,* 75 F. (2d) 977, 978-80.

In reversing the decision of the Second Circuit in the *McCandless* case,[4] this Court clearly foreshadowed ultimate rejection of the *Ball* rule. Pointing out the fictional quality of the consent of those who market when issued securities, this Court said, per CARDOZO, *J.*:

> "This is not a case where at the time of issuing the securities the shareholders and the promoters were the only ones concerned. * * * The promoters could not receive for themselves or deliver to subscribers the bonds and notes of the company secured by deed of trust until title had been acquired to the lands covered by the deed. On the other hand, they could not pay the purchase price and acquire title to the lands without the proceeds of subscriptions, the contributions of the public" (296 U. S. pp. 159-160).

Referring to the purchasers on the public offering, this court held:

> "Here at the moment of conveyance the interests of bondholders and noteholders were put in jeopardy * * *."

The state courts never adopted the legalistic and oppressive doctrine of the *Ball* case. On the contrary un-

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[4] There the when issued securities were bonds, not stock, and the reversal was on the broad ground that no stockholder's consent could bar the rights of creditors. However, this court expressly reserved judgment on the question

> "whether the corporation itself at the instance of new shareholders would be permitted to disaffirm the fraud and maintain a suit in equity for appropriate relief." (296 U. S. p. 160)

der New York law and under the law of every other state in which the question has been passed on, petitioner and the other holders of the interim receipts, despite the fact that they purchased from the bankers, were the original holders of the 450,000 shares and deceit practiced on them was deceit in the organization of United, for which it may recover. *Midwood Park Co.* v. *Baker,* 128 N. Y. Supp. 954, affd 144 App. Div. 939, affd 207 N. Y. 675; *Hyde Park Terrace Co.* v. *Jackson Bros. Realty Co.,* 161 App. Div. 699; *Arnold* v. *Searing,* 73 N. J. Eq. 262, 264-6; *California-Calaveras Mining Co.* v. *Walls,* 170 Cal. 285, 301; *Pittsburgh Mining Co.* v. *Spooner,* 74 Wisc. 307, 320-4; *Birbeck* v. *American Toll Bridge Co.,* 23 Del. Ch. 83, 95-6; *Nye Odorless Incinerator Corp.* v. *Felton,* 35 Del. 236.

In the *Midwood Park Co.* case as here the promoters obtained options on property, concealed the option price and caused a new corporation to agree to purchase the property at a higher figure, payable in cash and securities. With money subscribed for the securities by innocent parties, the promoters bought the property and conveyed it to the corporation, in consideration for which the securities were issued to the promoters and then transferred to the subscribers. As in the case at bar, the promoters there argued that the corporation had not been defrauded. Reaching a result which the courts below refused to follow in this case, the New York courts brushed aside all arguments based on the form of the transaction.[5] Holding that the corporation had been defrauded, the trial court said:

"The minutes of the incorporators and directors of

[5] The foregoing appears in part from the opinion in 128 N. Y. Supp. and in part from the findings, excerpts from which are set forth in Appendix I to this petition.

> the Kouwenhoven Company at the time of its organization, the exact phraseology of the resolutions approving the manipulations of Messrs. McLauchlin and Herd, by which it was sought to put $202,000 into their pockets without the knowledge of their associates, and without the expenditure of a dollar on their part, are of no avail. Equity cuts through all this legerdemain and lays bare the facts." (128 N. Y. Supp. p. 956)

The *Hyde Park Terrace Co.* case is another decision wherein the New York courts gave relief to a corporation for deceit practiced by the incorporators on the subscribers where the stock

> "was issued to the incorporators and distributed to the subscribers" (161 App. Div. p. 700).

In *Arnold* v. *Searing,* the Vice-Chancellor ruled:

> "The injury to complainants through the false representations made by defendants, was, in my judgment, an injury to them in their corporate rights." (73 N. J. Eq. p. 267)

In *Pittsburgh Mining Co.* v. *Spooner,* the Supreme Court of Wisconsin held:

> "The fraud in the sale was therefore a fraud upon the collective interests of the shareholders * * *." (74 Wisc. pp. 323-4)

Compare *Hutchinson* v. *Simpson*, 92 App. Div. 382, where bankers contracted to sell property to a new corporation in exchange for its stock. The bankers then sold part of the stock, when issued, on a prospectus which disclosed the above, but not the extent of their profit. A divided court refused to permit the plaintiff, who had purchased his stock from the bankers, to assail on behalf of the corporation the transaction whereby the bankers acquired the stock. Settled pending appeal to the New York Court of Appeals, the case has never been cited by that court. In the case at bar, on the contrary, the profit attacked arose not from the bankers' option on the 450,000 shares but out of independent transactions between Powell and Rogers, the vendor companies and United.

In *California-Calaveras Mining Co.* v. *Walls,* the Supreme Court of California reasoned:

> "* * * to the extent that these stockholders, through the fraudulent conduct of Manson, were injured, it was an injury to the corporation as representing their collective or corporate interests." (170 Cal. p. 301)

And of the leading case of *Erlanger* v. *New Sombrero Phosphate Co.,* 3 App. Cas. 1218, *Morawetz* (2d ed. p. 279) said:

> "The fraud really consisted in inducing the shareholders to enter into this contract in their collective capacity, and in using the funds belonging to the shareholders collectively in paying the purchase price. It is evident, therefore, that the injury to the shareholders was an injury to their collective or corporate interests, and that the company was the proper complainant."

In deciding the underlying question in this case, who were the original holders of the 450,000 shares, petitioner and the other deceived purchasers or the acquiescing bankers, the District Court ignored the salutary rule of state law above set forth, as well as its own finding (R. 1267) that for purposes of Federal Rule 23(b) petitioner was a shareholder at the time of the transaction complained of. Instead, expressly following the *Ball* doctrine and citing that and the *South Penn Collieries Co.* cases as authority, the court reached the wholly unrealistic, inequitable and inconsistent result that petitioner and the other deceived purchasers who, by their pre-organization subscriptions, had supplied United with its entire cash capital of $9,000,000, had no interest in the corporation at the time of its organization. On the contrary, although the bankers had sold

out a month and a half before their option on the 450,000 shares was exercised with the money deposited by petitioner and the other purchasers, the bankers remained the original stockholders, held the court. The bankers' consent, it was adjudged, bound United and as a matter of law precluded deceit practiced on the purchasers from operating as actionable injury to the corporation.[6]

This holding was in a real sense the turning point of the decision of the Circuit Court of Appeals, not the

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[6] Judge Conger stated in his opinion (R. 1237-40):

"Assuming the most favorable facts to the plaintiff, that there was a secret profit, in the sense that the profit was not disclosed to the public, the plaintiff must fail in the light of the facts of this case. There was a disclosure to every interested party when the transactions took place and they acquiesced in them. The only parties interested on February 28, 1929 were the vendors, the bankers and the corporation. There was a full disclosure to all."

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"In *Ball* v. *Breed, Elliott & Harrison*, 294 F. 227, • • • there were persons who had contracted to purchase stock when the transactions complained of occurred. There, as here, the contracts were with the bankers and not the corporation. The argument was advanced, as it has been here, that because of the prior dealings with the public by the members of the syndicate the public and the syndicate members became equitable stockholders at the time of the transactions complained of. The court held that all those in interest were informed and rejected the argument as to their being equitable stockholders. See also, *South Penn Collieries Co.* v. *Sproul*, 52 F. 2d 557; *Arn* v. *Dunnett*, 93 F. 2d 634.

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"I conclude from a reading of the cases that the turning point is whether the plaintiff is an original subscriber

statute of limitations.[7] Aside from *res judicata* and the effect of the reorganization,[8] questions not dealt with in its opinion, the sole issue in that court was who were the original holders of the 450,000 shares and was United deceived. Petitioner has always conceded that if he and the other purchasers were not original stockholders, the deceit practiced on them resulted in no actionable wrong to United. Respondents have never denied that if petitioner and the other purchasers were original stockholders, the discovery provision of the statute of limitations applied. And under that provi-

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of stock or not, for if he is there must be a disclosure to him. But where one is not an original subscriber but buys through a broker or banker, the corporation is not a party to that transaction. A cause of action for any wrong in that situation lies against the seller by the buyer.

"In the case at bar Laird was not an original subscriber. He bought his stock through the bankers. I, therefore, hold that the disclosures made by Powell and Rogers to the vendors, the bankers and the corporation and their acquiescence in the transactions bar this suit on the Crane and Shewan transactions."

[7] The opinion of the Circuit Court of Appeals contains the puzzling statement that

"There was no allegation or proof of fraud of the kind which is found in *Reno* v. *Bull*, 226 N. Y. 546, 550." (R. 1279)

In view of the clear allegation and proof of deceit practiced in the sale of the 450,000 shares to petitioner and the other purchasers, the statement can be given meaning only by reference to the District Court's erroneous holding of substantive law that the acquiescing bankers, not petitioner and the other deceived purchasers, were the original holders of that stock.

[8] For a brief statement of petitioner's position on these points, see Appendix II to this petition.

sion the suit was clearly timely, having been instituted after discovery of the facts within a few months out of the six years allowed by §48(5) of the New York Civil Practice Act for the commencement of such suits.

And so the Circuit Court of Appeals, after quoting (R. 1278) from the District Court's findings, concluded that the complaint did not state a cause of action for deceit against United since

> "'The said 4,400 shares of United Preferred were issued * * * with knowledge by all of the parties then interested in United * * *'"

i.e., the bankers, the vendor companies and the management. Any residual cause of action, for breach of duty and not for deceit, since

> "all parties then having any interest in, or holding any position of responsibility to, the corporation were fully aware of all the facts" (R. 1279),

accrued, held the court, on February 28, 1929 and was barred before this suit was commenced.[9]

Thus the courts below decided the fundamental question of substantive law in this case, who were the original holders of the 450,000 shares, petitioner and the other deceived holders of the interim receipts or the ac-

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[9] The mentioned provisions of the New York Civil Practice Act are set forth in Appendix III to this petition.

Hastings v. *Byllesby & Co.*, 293 N. Y. 404, and *Lever* v. *Guaranty Trust Co.*, 289 N. Y. 615, simply stand for the proposition, never contested by petitioner, that § 48(5) applies only to cases of deceit, not to cases of constructive fraud. In the *Hastings* case, the gravamen of the complaint was the use by the defendants of their control of an existing corporation to cause it to buy and sell securities at prices unfavorable to the corporation and yielding large profits to the fiduciaries (293 N. Y. pp. 408-9) Facts constituting deceit were not alleged.

quiescing bankers, pursuant to their own 1923 rule and contrary to the common law of the State of New York. As a result, the Circuit Court of Appeals held barred by limitation this suit, maintainable in the state courts as seasonably commenced within the provisions pertaining to cases of deceit. While paying lip service to *Erie Railroad Co.* v. *Tompkins* by stating that under *Guaranty Trust Company* v. *York* the state statute of limitations should be followed, the Circuit Court of Appeals effectively nullified the *Erie* rule and the state law applicable thereunder.

The importance of the *Erie* rule as a guide to the distribution of judicial power between the state and federal governments need not be stressed in this Court. As has been recently stated, a "policy so important to our federalism" must be "applied with an eye alert to essentials in avoiding disregard of State law in diversity cases in the federal courts";[10] and such a policy must be protected against unexpressed and perhaps unintentional encroachment, with which it is so much more apt to be assailed than with deliberate and avowed disregard.

Likewise, in the *Lever* case, the cause of action was for using the defendants' control of the corporation to cause it to pay their obligation (289 N. Y. pp. 616-18).

In *Mannaberg* v. *Klausner*, 294 N. Y. 859, it was held that a cause of action for breach of duty perpetrated by deceit by one joint adventurer against others, among whom a fiduciary relationship existed, is subject to the discovery provision of § 48(5). To the same effect, see *Brundige* v. *Bradley*, 294 N. Y. 345, 349.

[10] *Guaranty Trust Co.* v. *York*, 326 U. S. 99, 110.

But if illustration be desired, the broadly remedial nature of the state law here ignored illustrates the significance of the *Erie* rule as part of our constitutional system. Under the case at bar, and under the line of lower federal court decisions to which it gives new life and importance, a corporation has no redress for fraud, no matter how gross, committed in its promotion, if its original shares are optioned to the promoters or bankers who market such shares and if these distributors of securities acquiesce. Pronounced by the federal courts in New York, financial center of the country, the decision frustrates, at least to the extent that diversity jurisdiction may be invoked through removal, a salutary rule of state common law under which such a corporation is held to have sustained actionable wrong. It would be in the public interest to prevent that abuse of federal jurisdiction even if such abuse were not, under the *Erie* doctrine, unconstitutional.

And unless made necessary by a compelling rule of law, found directly applicable after the fullest review, the flagrantly corrupt and illegal conduct by corporate insiders disclosed in this case ought not to go without remedy in the national courts.

CONCLUSION

It is respectfully submitted that this petition for writ of certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

JOHN A. LAIRD,
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Counsel for Petitioner.

APPENDIX I

Excerpts from findings of fact and conclusions of law of the court in *Midwood Park Co.* v. *Baker*, 128 N. Y. Supp. 954.

"57. On the 1st day of May, 1906, the first meeting of the incorporators named in the certificate of incorporation of the defendant Kouwenhoven Realty & Improvement Company was held, and at the said meeting a proposition was submitted by said Anderson T. Herd, which is in the words and figures following:

To the President and Board of Directors
Kouwenhoven Realty & Improvement Co.

Gentlemen:

I propose to sell and agree to have conveyed to the Kouwenhoven Realty & Improvement Company two certain tracts of land located in the Borough of Brooklyn, County of Kings, and City of New York, lying in Sections 15, 23 and 24 on the Land Map of Kings County, two tracts of land.

One known as the Wyckoff Farm, containing 42 acres and 773/1000 acres, fully described by metes and bounds on plot attached to this proposition.

The other tract of land containing 176 acres and 439/1000 acres, is what is known as the Cornelius B. Kouwenhoven Farm, the tracts lying adjacent to each other. Certain rights of way acquired by the Long Island Railroad, in the City of New York, it will be observed, with several other minor reservations, are not to be included. A plot of the Kouwenhoven tract, duly surveyed, is likewise attached to this proposition of sale, both tracts being described by metes and bounds and to be described by metes and bounds in the conveyance to you.

Your Capital Stock, I understand, is $650,000. I propose that $216,000 of the par value of this stock be retained in your Treasury for the making of improvements in the way of streets, sidewalks, curbs, planting of trees, if desired.

That you shall turn over to me the remainder of said stock, amounting to $434,015.22, or cash for the same at par, excepting so much of the same as

is now being subscribed and paid for, which said sums shall be now applied toward the payment of the property in taking title.

The Kouwenhoven Realty & Improvement Company takes title subject to five mortgages, two for $356,941.98 and $1,949, respectively, resting on the Kouwenhoven tract; two for $93,000 and $8,051, respectively, resting on the Wyckoff tract, and one for $202,102.80, resting upon both tracts, making a total of $662,044.78, which, with the $434,015.22 of the Capital Stock, will make the purchase price of the property, namely $1,096,060.

Respectfully submitted,
ANDERSON T. HERD.

The said incorporators then and there passed a resolution, which is in the words and figures following:

WHEREAS, This Company was incorporated under the laws of the state of New York for the purpose set forth in the Certificate of Incorporation:

WHEREAS, It was the intention of the incorporators, among other things to purchase and take over the property mentioned in said proposal; and

WHEREAS, The said Herd has made a proposition for the sale of said property to this corporation for the sum mentioned in said proposition; and

WHEREAS, It appears, after due consideration and investigation that it is necessary and advantageous for the best interests of this Company that it acquire, purchase and take over said property and make the payments therein called for:

NOW, THEREFORE, BE IT RESOLVED, That this Company do purchase the said property for the sum mentioned in said proposition and pay for the property described in said proposition the sums therein specified and at the times therein mentioned, and that the said Company does hereby fully accept all the terms and conditions set forth in said proposition; and

BE IT FURTHER RESOLVED, That the aforesaid proposition, together with a copy of this Resolution, be referred to the Board of Directors, and we hereby authorize and instruct our said Board of Directors to perfect the acquisition and purchase of said property therein described, provided that the judgment of the Board of Directors of this Company concur in our opinion of the value of the property to be purchased."

* * * * * *

"60. On the 2nd day of May, 1906, the directors named in the certificate of incorporation for the first year of the Kouwenhoven Realty & Improvement Company met, when four of them resigned and Aaron McNeill, James M. Potter, Peter Brooks and Charles B. Wing, the latter two of whom were members of the syndicate, Exhibit F, were duly elected in their places.

The majority of said Board of Directors was composed of the servants, agents and employees of the said Anderson T. Herd and Charles W. Baker, and was under the absolute control and dictation of said Anderson T. Herd and Charles W. Baker and did not exercise an independent judgment."

"61. Anderson T. Herd was present at the said meetings of incorporators and directors held on the 1st and 2nd of May, 1906, respectively, dominating and controlling the proceedings, prepared the minutes and secured the passage of a resolution accepting his said proposition theretofore submitted to and accepted by the incorporators and which was received in evidence and marked Exhibit R2.

"62. Neither the said Anderson T. Herd nor Charles W. Baker, nor any person on their behalf, disclosed at said meeting of directors on the 2nd of May, 1906, the fact of their interest in the contracts between Midwood Park Company and Brooklyn Realty Trading Company and Bertha G. McLaughlin and Anderson T. Herd for the purchase of the Kouwenhoven and Wyckoff tracts at the sum of $2,750 and $3,150 per acre, respectively,

but the said Anderson T. Herd and Charles W. Baker concealed and suppressed the truth as to their connection with and interest in said contracts."

The foregoing excerpts appear at pp. 65-69 of the record on appeal to the New York Court of Appeals (203 N. Y. 545). Other portions of the decision of the court dealing with the promoters' secret profit are findings 22-24, record pp. 46-54; findings 42, 43, 45, 47, 48, 50-55, 58, 62-65, 67-71, 77-85, record pp. 61-77; conclusion of law 11, record p. 85.

APPENDIX II

District Court's Alternative Grounds of Decision

In addition to the holding that deceit practiced on petitioner and the other purchasers on the public offering did not constitute fraud on United because they were not original stockholders, the District Court placed its judgment on the following further grounds: (1) that the cause of action asserted by petitioner was vested in the debtor in possession in the § 77B proceedings and that the reorganized debtor, although the same corporation, is a separate entity from the debtor in possession and is not now vested with the cause of action (R. 1246-8); (2) that since the cause of action now asserted could have been interposed by United to defeat the claims of Powell and Rogers in the reorganization, allowance of their claims renders this cause of action *res judicata* (R. 1249-50). In view of the limited scope of the decision of the Circuit Court of Appeals, no detailed statement of petitioner's position on these points is here attempted.

Briefly, however, if this court reverses on the question of fraud, so that the statute of limitations does not bar the suit, petitioner and United would be entitled to a reversal in the Circuit Court of Appeals on the District Court's further grounds because: (1) Where, as here (R. 1026), no trustee is appointed, the bankrupt is not divested of its assets, *Danciger* v. *Smith*, 276 U. S. 542. But even if a trustee had been appointed, confirmation (R. 1204-5) of the plan would have revested the debtor. See § 70(f) of the Bankruptcy Act of 1898, 30 Stat. 566, effective in 1936 when United's plan was confirmed, also present § 70(i). See also *Meyer* v. *Fleming*, 327 U. S. 161. (2) Since the issues in this suit are different from those litigated on proof of the claims of Powell and Rogers in the reorganization, the cause of action in this suit is not *res judicata* by reason of the allowance of claims in those proceedings even though if disclosed and interposed in the reorganization, the cause of action would have constituted a defense to such claims. Restatement of Judgments, § 68 (2); *Weinert* v. *Kinkel*, 269 App. Div. 401, affd N. Y. 151; *Virginia-Carolina Chemical Co.* v. *Kirven*, 215 U. S. 252, 257-9.

APPENDIX III

Statute of Limitations

As amended by N. Y. Laws of 1939, c. 359, § 2, N. Y. Civil Practice Act, § 48 provided:

> "The following actions must be commenced within six years after the cause of action has accrued:
>
> • • • • • •
>
> "*5. An action to procure a judgment on the ground of fraud.* The cause of action in such case is not deemed to have accrued until the discovery by the plaintiff, or the person under whom he claims, of the facts constituting the fraud."

For this purpose, knowledge of the wrongdoing directors is not imputed to the corporation. *Hifler* v. *Calmac Oil & Gas Corp.*, 258 App. Div. 78, 90; *Goldberg* v. *Berry*, 231 App. Div. 165, 170; *Brinkerhoff* v. *Roosevelt*, 143 Fed. 478, 483, *cert.* den. 200 U. S. 622. See also *Mencher* v. *Richards*, 256 App. Div. 280, 282; *Pollack* v. *Warner Bros. Pictures, Inc.*, 36 N. Y. Supp. (2d) 681, 684, modified 266 App. Div. 118; *Loughman* v. *Pitz*, 36 F. Supp. 302, 305; *Colton Improvement Co.* v. *Richter*, 26 Misc. 26, 31.

The ten year statute of limitations, relied on in the Circuit Court of Appeals by respondents and apparently applied by the court is as follows:

> "§53. *Limitation where none specially prescribed.* An action, the limitation of which is not specifically prescribed in this article must be commenced within ten years after the cause of action accrues." (N. Y. Civil Practice Act).

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No. 440

Supreme Court of the United States

OCTOBER TERM, 1947

JOHN A. LAIRD, PETITIONER

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE SECOND CIRCUIT COURT OF APPEALS

PETITIONER'S REPLY BRIEF

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ON PETITION FOR A WRIT OF CERTIORARI TO THE SECOND CIRCUIT COURT OF APPEALS

PETITIONER'S REPLY BRIEF

I

Substance of respondents' argument stated and replied to

Respondents argue in substance that the decision of the Circuit Court of Appeals does not breach the *Erie* doctrine by failing to apply the New York law in determining who were the original holders of the 450,000 shares because:

(a) United was not defrauded irrespective of who were the original holders of the 450,000 shares, and the suit was therefore barred by limitation in any event.

(b) Under New York law the bankers, not petitioner and the other purchasers, were the original holders of the 450,000 shares.

Each branch of this argument is fallacious.

(a) The Circuit Court of Appeals did not decide the case on the theory that United had not been defrauded irrespective of who were the original holders of the 450,000 shares. On the contrary, its decision was explicitly placed on the ground that as held by the District Court, all parties other than Powell and Rogers interested in United on its organization, *i.e.*, the bankers and the vendor companies, were fully aware of the facts (R. 1279). And underlying that and basic to this application is the conclusion, elaborately reasoned by the District Judge,[1] that petitioner and the other purchasers as a matter of law were not original stockholders.[2]

(b) Seeking to obscure the broad federal question which the petition presents and to make this application for *certiorari* appear to turn on a close question of New York law, respondents assert that the substan-

---

[1] See petition, pp. 12-14.

Contrary to respondents' claims, the Circuit Court of Appeals did not "affirm all the facts found below" (Powell brief, p. 2). In that court's view, application of the statute of limitations required no more than affirmance of the District Court's conclusion that the acquiescing bankers, not petitioner and the other deceived purchasers, were the original holders of the 450,000 shares and that therefore the transaction complained of was known to all parties interested in United at the time of its organization (R. 1279).

Neither court went beyond this conclusion of law doubtless because the evidence of deceit in the sale of the shares was undisputed as to petitioner and virtually undisputed as to Baker-Scott. Petition, pp. 3-4.

[2] Since this was a determination of law, not fact, the "concurrent findings" rule on which respondents rely (Powell brief, p. 3, Chase brief, pp. 12-13), does not apply.

tive law of New York as to who were the original holders of the 450,000 shares of common stock is exactly contrary to what petitioner states it to be. On that basic question, argues The Chase,[3] the decision below is based on New York law, not on a doctrine of the lower federal courts which ignores the state rule.

This bold claim is utterly without foundation. *Blum* v. *Whitney*, 185 N. Y. 232, and the ten other cases which respondents cite on this point stand merely for the proposition stated at page 8 of the petition, in the margin, that the corporation may not complain of a transaction assented to by those who at the time own all of its stock. As made clear in *Goldstein* v. *Tri-Continental Corp.*,[4] N. Y. Law Journal, June 21, 1938, that principle of course, does not apply where, as here, at the time of the transaction, the corporation has non-assenting stockholders. Overruling a demurrer to the complaint in that case, Mr. Justice SHIENTAG (now a justice of the Appellate Division) stated for the Supreme Court, New York County:

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[3] Chase brief, pp. 10-11.

[4] Only when the defendants by a further showing satisfied the court that at the time of the agreements attacked, the promoters were the sole parties in interest, did Mr. Justice COLLINS reach the decision on which respondents rely. There at the time of the transactions complained of, the bankers "had made no contract to sell a single share * * * to anyone, on a 'when issued' basis or otherwise". These facts clearly distinguish Mr. Justice COLLINS' decision from the case at bar, where petitioner and the other deceived purchasers had actually contributed United's entire cash capital of $9,000,000 when the $440,000 par value of preferred stock was secretly issued to Powell and Rogers. Petition, pp. 3-6.

"*Blum* v. *Whitney*, 185 N. Y. 232, is not authority in support of the contentions of the defendants on this point. There the defendant promoters owned all of the stock of the corporation, which under the scheme of promotion was to be distributed, and it was not intended that stock would subsequently be sold to uninformed stockholders after the execution of the wrongful contract. The promoters, as the owners of all of the stock of that corporation, were in effect dealing with themselves. Here it does not appear that Seligman & Co. owned all of the stock * * *. The complaint indicates sufficiently that the promoters were not dealing with themselves alone so as to preclude subsequent stockholders from seeking redress."

II

Respondents' cases on the statute of limitations additional to those cited by the Circuit Court of Appeals are not in point on any question here in issue

In addition to the *Hastings* and *Lever* cases, which the Circuit Court of Appeals cited,[5] respondents relied in that court as well as here on *Teich* v. *Lawrence*, 291 N. Y. 245, *Gobel, Inc.* v. *Hammerslough*, 288 N. Y. 653, and *American Cities Power & Light Corp.* v. *Williams*, 69 N. Y. Supp. (2d) 197 (Supreme Court, New York County, unreported officially).

Like the *Hastings* and *Lever* cases, the *Gobel* and *Williams* cases hold no more than that § 48(5) applies only to cases of deceit,[6] a proposition not in issue either here or in the court below.

Teich v. *Lawrence* is not even remotely in point. The

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[5] These cases are discussed in note 9, petition, pp. 15-16.

[6] In the *Gobel* case, the record (pp. 109, 127) shows disclosure, not concealment and in the *Williams* case, there was concealment subsequent to the acts complained of, not deceit.

Appellate Division held the first cause of action alleged in the complaint in that case to be for "actual fraud" and so within § 48(5) because

> "respondents participated in a scheme wherein certain stock was sold to Equity Corporation's subsidiary for a grossly inflated price * * *" (265 App. Div. 974, 975).

The Court of Appeals reversed, pointing out that

> "The present complaint alleged no fraud upon the defendant corporation in whose behalf the plaintiffs sue" 291 N. Y. p. 249.

III

Certain misstatements in brief of Powell and Rogers corrected

(a) *Pp. 2, 3.* The District Court made no finding that the cause of action alleged "accrued more than 10 years before suit." The court found that the transactions complained of were "consummated * * * more than ten years prior to the institution of this suit" (R. 1267). The distinction is vital. A cause of action for deceit, such as petitioner alleged, accrues only upon discovery, but must be commenced within six years after such accrual.[7]

(b) *P. 5.* Petitioner does not admit the claim, never before advanced by respondents, that the false representations were made by United itself. The representations were made not by United, but by Morse, its president, who signed and sent the letter with the knowledge and for the benefit of Powell and Rogers,[8] who are therefore liable for the damages resulting therefrom. In each of the New York cases relied on by petitioner

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[7] The statute is set forth in Annex III to the petition.

[8] Petition, p. 4.

on this point,[9] the representations were made, as here, in connection with solicitation of the original capital of the corporation. In each case it was held that the promoters defrauded the corporation, not that the corporation defrauded itself or its original stockholders, as respondents suggest.

(c) *P. 7.* Doubtless in an attempt to make a showing in mitigation of the harsh but indisputable (and undisputed) facts set forth in the petition, respondents state that they intended and attempted unsuccessfully to resell for $1,700,000 the $2,140,000 par value of United securities which they secured at the closing for the $1,700,000 advanced to them by The Chase. And The Chase stoutly contends that the $1,700,000 was a real loan in the regular course of business which Powell and Rogers were obliged to repay, irrespective of the collateral. Thus respondents argue that Powell and Rogers obligated themselves to repay $1,700,000 with no thought of profit and solely to accommodate the bankers and the vendor companies, who on respondents' theory were the only other persons then interested in United. Be this as it may, contrary to respondents' assertion the record is devoid of evidence as to the price at which the securities were offered for resale.

(d) *P. 9.* The District Court did not hold that the transaction set forth in the petition was authorized by the charter. It discussed the charter and cited *Everett*

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[9] *Colton Improvement Co.* v. *Richter*, 26 Misc. 26, 31; *Midwood Park Co.* v. *Baker*, 128 N. Y. Supp. 954, 955, affd 144 App. Div. 939, affd 207 N. Y. 675; *Hyde Park Terrace Co.* v. *Jackson Bros. Realty Co.*, 161 App. Div. 699, 700-1; *Crowe* v. *Malba Land Co.*, 76 Misc. 676.

v. *Phillips*, 288 N. Y. 227, in connection with a completely separate *devastavit* (R. 1240, 1243), with which the appeal to the Circuit Court of Appeal was not concerned.

(e) *P. 10.* Not even a scintilla of evidence in the record substantiates the gratuitous assertion that a good sale of the properties made after the outbreak of World War II was the incentive for bringing this suit. The sale was not a good sale. As shown at pp. 1409-10 of the record filed in the Circuit Court of Appeals, but unprinted, the assets were sold for a figure which left $595,578.88 for the Class B stock, into which the old common stock had been converted, a loss of approximately 96% of the original investment of petitioner and the other purchasers. In the 77B proceedings, these stockholders had been deprived of the right to vote on the proposed sale (R. 1153, 1186, 1204-5). Furthermore, petitioner has never doubted the ability of respondents to satisfy any judgment herein.

CONCLUSION

The briefs in opposition contain no valid answer to the petition, the prayer of which should be granted.

Respectfully submitted,

ROBERT P. WEIL,
GERALD L. WALLACE,
Counsel for Petitioners.

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Supreme Court of the United States

OCTOBER TERM, 1947

No. 440

JOHN A. LAIRD, *Petitioner,*

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT UNITED SHIPYARDS, INC., ON PETITION FOR WRIT OF CERTIORARI.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 440

JOHN A. LAIRD, *Petitioner,*

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT UNITED SHIPYARDS, INC., ON PETITION FOR WRIT OF CERTIORARI.

Statement.

The following brief is filed on behalf of United Shipyards, Inc., for purposes of the record.

Respondent, United Shipyards, Inc., a New York corporation, was organized on December 13, 1928 under the name of United Dry Docks, Incorporated (fol. 3752).

On May 5, 1936, pursuant to a plan of reorganization in the United States District Court for the Southern District of New York, in Bankruptcy No. 60212, the name of United Dry Docks, Incorporated, was changed to United Shipyards, Inc. (fol. 3752).

United Shipyards, Inc., was dissolved December 19, 1939 and liquidated pursuant to a plan of complete liquidation (fol. 3752).

This suit was commenced by the filing of the complaint on September 18, 1940.

The opinion of the District Court, dated August 14, 1943 (R. 1230-1250) is not reported. Findings of Fact and Conclusions of Law are dated January 17, 1944 (R. 1251-1269) and Judgment was rendered February 1, 1944 (R. 1270-1271).

The opinion of the Circuit Court of Appeals, dated August 13, 1947 (R. 1274-1279) is reported at 163 F. (2d) 12, and judgment was entered thereon on the same date (R. 1280).

Dated: December 2, 1947.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM.

No. 440.

JOHN A. LAIRD, Petitioner,

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF IN OPPOSITION OF THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

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IN THE

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BRIEF IN OPPOSITION OF THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

Opinions Below.

The Opinion of the District Court (R. 1230-1250) is unreported. The Opinion of the Circuit Court of Appeals is reported at 163 F. (2d) 12.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered August 13, 1947 (R. 1280). The petition for a writ of certiorari was filed November 13, 1947 and served November 14, 1947. The jurisdiction of this Court is

invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Involved.

The petition for certiorari, implying (Pet., p. 2) that the court below ignored state law in violation of *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64 (1938), and *Guaranty Trust Co.* v. *York,* 326 U. S. 99 (1945), misstates the issues. The only possible questions which could justifiably be presented on this petition are:

(1) Whether the court below correctly interpreted and applied decisions of the New York Courts pursuant to which it held that the New York ten year statute of limitations bars the action.

(2) Whether the District Court correctly applied New York law in dismissing the action on the merits upon the basis of the Record and its Findings of Fact.

Reason for Denying Petition.

The petition fails to show that this case was decided "probably in conflict with applicable local decisions". Contrary to the claim in the petition, both courts below applied New York law, not "federal" law. The District Court's dismissal on the merits, based primarily upon the facts, is in conformity with applicable New York law as exemplified by decisions of the New York courts cited in its opinion. The Circuit Court of Appeals, expressly recognizing that *Guaranty Trust Co.* v. *York, supra* (decided after the District Court opinion), required application of

the New York statute of limitations, dismissed solely on that basis, in strict conformity with this Court's mandate in that case.

Statute Involved.

The New York statute of limitations upon the basis of which the Circuit Court of Appeals affirmed dismissal of the action herein is Section 53 of the New York Civil Practice Act, reading as follows:

> "§53. **Limitation Where None Specifically Prescribed.** An action, the limitation of which is not specifically prescribed in this article, must be commenced within ten years after the cause of action accrues."

Statement.

This is a derivative stockholders' suit, commenced September 18, 1940, to recover alleged secret promoters' profits claimed to have been made more than 11 years prior to commencement of the action by Respondents Rogers and Powell through their receipt of 4,400 shares of preferred stock in the Crane and Shewan transactions incident to the organization of the predecessor of Respondent United Shipyards, Inc. (hereinafter called "United") in February, 1929, and to impress a constructive trust upon stock then obtained by Respondents other than United (Amended Complaint, Prayers A and C, R. 46.40). Respondent The Chase National Bank of the City of New York (hereinafter called the "Bank") was sued as an alleged co-participant in the breach of fiduciary obligation charged to Respondents Rogers and Powell (R. 1279).

After a trial which lasted eight days (R. 2), the District Court entered a final judgment of dismissal on the

merits (R. 1270). In its Opinion (R. 1230-1250) and Findings (R. 1251-1269) the District Court specifically found that there had been no fraud, breach of fiduciary obligation or overreaching by any of the defendants (R. 1236, 1237, 1238, 1240; R. 1254, 1259-60, 1266-67) and also ruled that the confirmation of a plan in a 77-B reorganization proceeding of the corporate defendant was *res adjudicata* (R. 1249, 1269). The District Court left undecided the defense of the New York statute of limitations pleaded by the defendants (R. 1250, 1269), but made a finding that the cause of action accrued more than 10 years prior to commencement of the action (Finding 83, R. 1267).

On appeal, the Circuit Court of Appeals for the Second Circuit reviewed the facts at length in its opinion (R. 1274-1279), specifically referring without disagreement to the District Court's Findings as to the absence of fraud and overreaching (R. 1275, 1278, 1279), and then disposed of the appeal solely on the basis of the statute of limitations defense not ruled on by the District Court, writing:

> "in our opinion the New York statute of limitations is a bar to the suit" (R. 1279).

Plaintiff's contention is that the Bank in making a $1,700,000 loan to Respondents Powell and Rogers was a co-participant with them in the Shewan and Crane transactions, involving an alleged breach of their fiduciary obligation to United, and that it so participated because it was an insufficiently secured creditor of the W. & A. Fletcher Co. whose assets were acquired by United. But so complete was plaintiff's failure of proof as against the Bank that the trial court at the close of the case commented (R. 1620) as follows:

"The Court: I can't see where the Chase is in any way, shape or manner involved. That is the way I feel."

Moreover, consistent with the affirmative and uncontradicted evidence directly disproving plaintiff's contentions as against the Bank (Ex. L-1, R. 727, at 731; R. 154, 100-101; 52, 127; 48, 53, 121), the District Court made specific Findings of Fact, as follows:

(1) The Fletcher loan was sufficiently secured for the Bank to have reasonably anticipated realization of the full amount loaned regardless of the consummation of the transactions complained of. (Findings 19, 20 and 21, R. 1254.)

(2) "Neither The Chase nor any other defendant participated in any scheme or conspiracy in connection with the formation of United or the purchase of its properties." (Finding 18, R. 1254.)

(3) The Bank's $1,700,000 loan to Messrs. Powell and Rogers was not even broached to it "until two or three days prior to the closing date", and "was made by The Chase in the ordinary course of business and not for any improper motive or pursuant to any scheme or conspiracy". (Findings 39, 40 and 41, R. 1259.)

(4) "The Chase * * * with reference to the Crane and Shewan transactions, did not participate with Messrs. Powell and Rogers or any other defendants in any scheme or conspiracy to defraud United or to make secret profits at the expense of United and did not make any such secret profit." (Finding 42, R. 1259-1260.)

(5) "The Chase * * * did not share with Messrs. Powell and Rogers in any profit secret or otherwise

which they might have made out of the Crane and Shewan transactions." (Finding 43, R. 1260.)

(6) "None of the defendants or any of them conspired to defraud or injure United or any of its stockholders, present or prospective, nor did the defendants nor any of them conspire to gain a profit at the expense of United or any of its stockholders." (Finding 79, R. 1266.)

The Circuit Court of Appeals, after carefully analyzing the facts, stated with reference to the Bank (R. 1279):

> "The Chase Bank was alleged to have aided in the breaches of fiduciary duty charged to Rogers and Powell as above set forth, it being argued that it was an insufficiently secured creditor of the W. & A. Fletcher Co., and thus moved so to do, **though that was neither found nor proved.**" (Emphasis ours.)

Argument.

1. The Court Below Correctly Held the Suit Barred by the Applicable New York Ten-Year Statute of Limitations.

The District Court in dismissing on the merits found it unnecessary to rule upon the defense of the statute of limitations (R. 1250), because, as the Circuit Court of Appeals pointed out in its opinion (R. 1279), the District Court's decision antedated *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945).[1] However, the appeal was argued after that decision, which made it so clear that the action was barred by the New York ten-year statute of limitations

[1]It should be noted that plaintiff contended in the District Court that this action was a purely equitable one to which only laches, and not the state statute of limitations applied (Pl. Supp. Tr. Br., p. 90; Rep. Br., pp. 10-41).

that the Circuit Court of Appeals disposed of the case *solely* on that basis, and in strict compliance with this Court's mandate in the *Guaranty Trust* case, writing (R. 1279):

> "We find it unnecessary to set forth in greater detail either the facts found or the claims made by the respective parties for in our opinion the New York statute of limitations is a bar to the suit.
>
> "There was no allegation or proof of fraud of the kind which is found in *Reno* v. *Bull,* 226 N. Y. 546, 550. Such fraud must necessarily be pleaded and proved to establish a cause of action on which, by virtue of Sec. 48(5) of the Civil Practice Act, the statute does not begin to run until discovery. *Hastings* v. *Byllesby & Co.,* 293 N. Y. 404. Consequently, there was no coupling of an allegation of such fraud with an allegation of a breach of fiduciary duty to make *Mannaberg* v. *Klausner,* 294 N. Y. 859, applicable. Here we have but a suit on the derivation of a corporation whose fiduciaries, it is alleged, have committed breaches of their duty to it. It has been proved and found that at the time such alleged breaches of duty occurred all parties then having any interest in, or holding any position of responsibility to, the corporation were fully aware of all the facts. That was no later than February 28, 1929, and then the alleged cause of action accrued. *Hastings* v. *Byllesby & Co., supra; Lever* v. *Guaranty Trust Co.,* 262 App. Div. 1044; aff'd 289 N. Y. 615. Nor is the statute tolled because those alleged to have been derelict in their duty were in control of the corporation. *Hastings* v. *Byllesby & Co., supra.*
>
> "It may be that the trial judge did not base his decision upon this ground because *Guaranty Trust Co.* v. *York,* 326 U. S. 99, had not then been decided. That case now shows conclusively that the New York statute of limitations does apply. That statute, as

> construed by the New York courts, had run before this suit was brought."

This represents an accurate summary and application of New York law. See, in addition to the cases cited by the Circuit Court of Appeals, *Teich* v. *Lawrence,* 291 N. Y. 245, 249 (1943); *Gobel, Inc.* v. *Hammerslough,* 288 N. Y. 653 (1942); *American Cities Power & Light Corp.* v. *Williams,* 69 N. Y. Supp. (2d) 197,202-3 (Sup. Ct., N. Y. Co., Mar. 20, 1947).

Petitioner, in an effort to enlist the interest of this Court in the petition for certiorari, claims no less than four times in the petition *(i. e.,* pp. 1, 2, 6, 14) that the present suit sounds in fraud and deceit. But a mere examination of the amended complaint shows that it is solely in equity for an accounting for profits. Plaintiff neither pleaded nor proved the classic elements of a fraud action, namely, misrepresentation, *scienter,* reliance and damage, *all* of which, under the decisions of the New York courts *(supra)* must be pleaded and proved in order to make applicable the "fraud" statute of limitations in Section 48(5) of the New York Civil Practice Act. It was because of the complete failure to plead or prove facts necessary to a fraud action, not because of any "federal rule" on promoter's liability,[2] that the Circuit Court of Appeals correctly rejected the claim now relied on in the petition

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[2] The petition erroneously states (p. 14) that "Respondents have never denied that if petitioner and the other purchasers were original stockholders, the discovery provision of the statute of limitations applied." On the contrary, both in the Trial Court (Pr. Tr. Memo., pp. 26-27) and on appeal (Br., pp. 21-24) the Bank contended that the "fraud" statute of limitations was not applicable because no fraud action was pleaded or proved regardless of whether petitioner was an original stockholder or not.

(made for the first time before the Circuit Court of Appeals), stating (R. 1279):

> "there was no allegation or proof of fraud of the kind which is found in *Reno* v. *Bull,* 226 N. Y. 546, 550."

In short, petitioner's argument that the court below failed to comply with the requirements of *Guaranty Trust Co.* v. *York,* 326 U. S. 99 (1945), is wholly without validity.

2. In Dismissing on the Merits for Plaintiff's Failure to Prove Fraud, Conspiracy or Breach of Fiduciary Obligation, the District Court Correctly Applied New York Law, Not Any So-Called "Federal" Rule.

The primary basis upon which petitioner seeks certiorari is his contention that the court below applied what petitioner chooses to call (Pet. pp. 1, 8) "the 'federal' rule" as to promoters' liability, instead of applying the New York law on this subject as required by *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64 (1938) (see Pet. pp. 1-2, 7-15).

Petitioner's argument overlooks the fact that, as above shown, the Circuit Court of Appeals, after independently reviewing the facts in its opinion, placed its decision of affirmance squarely upon the New York statute of limitations, which it construed and applied correctly in accordance with New York decisions.

Beyond this, petitioner's argument completely ignores that the District Court, in dismissing on the merits, did so not on the basis of federal law as against state law or vice versa, but on the basis of express findings of fact set forth in its opinion, that:

> "(1) I am satisfied from the explanation that it was not a secret profit fraudulently secured" (R. 1236);

(2) "nothing was secret. * * * There was no attempt at concealment." (R. 1237);

(3) "It is really a conspiracy that is charged. The evidence discloses no such scheme or conspiracy, neither may one be spelled out from the facts. Plaintiff has failed to make out a case against either the Bank or Aldred." (R. 1240).

But even assuming, *arguendo*, that the decision on the merits was based primarily upon a rule of law that a promoter's profit acquiesced in by the vendors and the bankers binds the corporation, including those who purchase shares from the bankers, that rule of law is the *New York rule*,[3] as exemplified in the leading case of *Blum* v. *Whitney*, 185 N. Y. 232, 241, 247 (1906), which has been consistently applied by the New York courts, without deviation, for more than seventy years. See *Seymour* v. *Spring Forest Cemetery Assn.*, 144 N. Y. 333, 340 (1895); *Thornton* v. *Wabash Ry. Co.*, 81 N. Y. 462, 467 (1880); *Continental Securities Co.* v. *Belmont*, 168 App. Div. 483, 489-490 (2nd Dept., 1915), affd. 222 N. Y. 673 (1918); *Bostwick* v. *Young*, 118 App. Div. 490, 496 (3rd Dept., 1907), affd. 194 N. Y. 516 (1909); *Insurance Press* v. *Montauk Wire Co.*, 103 App. Div. 472, 477-480 (1st Dept., 1905); *Goldstein* v. *Tri-Continental Corp'n*, N. Y. L. J. Dec. 19, 1940, p. 2116, (Sup. Ct. N. Y. Co., 1940); *East Lake Lumber Co.* v. *Van Gorder*, 105 Misc. 704, 715 (Sup. Ct., Erie Co., 1919); *Schlesinger* v. *Fisk*, 60 Misc. 442, 442-3 (Sup. Ct., N. Y. Co., 1908); *Flanagan* v. *Lyon*, 54 Misc. 372, 377-378 (Sup. Ct., N. Y. Co., 1907); *Parsons* v. *Hayes*, 14 Abb. N. C. 419, 432-434 (Super. Ct., 1883).

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[3] If there is any different "federal" rule on this subject, it must be that embodied in *McCandless* v. *Furlaud*, 296 U. S. 140 (1935), which petitioner himself contends (Pet., p. 8) is *contrary* to the New York rule applied in this case.

Petitioner's repeated attempt to distinguish the present case upon the ground that the bankers who had purchased the stock of United had arranged to sell the same through the issuance of their interim receipts to the plaintiff and others, represents an approach which has often and explicitly been rejected by the New York Courts. See *Hutchinson* v. *Simpson*, 92 App. Div. 382 (1st Dept. 1904);[4] *Goldstein* v. *Tri-Continental Corp.*, N. Y. L. J., Dec. 19, 1940, p. 2116 (Sup. Ct., N. Y. Co. 1940). In the case last cited, the Court wrote:

> "* * * *Blum* v. *Whitney* (185 N. Y. 232) appears to hold that a subsequent stockholder is not such an interested or defrauded party that he can successfully attack the transaction. To state it differently, he would not be the 'party injured'. The line of demarcation which the plaintiff essays to etch between the Blum case and his own, is too tenuous for discernment. *In that case, too, the promoters purchased most of the stock with the intention to sell it to the public, and this intention was executed at considerable profit to the promoters.* In other re-

[4] *Hutchinson* v. *Simpson*, holds squarely that holders of interim receipts issued by bankers are not stockholders for purposes of the rule of *Blum* v. *Whitney*. It should be noted that petitioner cites for what he contends to be the New York rule only two lower court decisions, relying mainly upon *Midwood Park Co.* v. *Baker*, 128 N. Y. Supp. 954 (1910), where the facts are wholly distinguishable, where the lower court opinion did not even pass upon this point and where no opinion was written by any appellate court. Apparently unable to distinguish *Hutchinson* v. *Simpson*, Petitioner (Pet. fn. p. 11) states that "the case has never been cited" by the Court of Appeals. But the case clearly represents the law of New York on the point, for it was deemed *controlling* in the Appellate Division decision in *Blum* v. *Whitney*, 111 App. Div. 922 (1st Dept. 1906), which the Court of Appeals affirmed 185 N. Y. 232 (1906), and was cited with approval *after* the *Midwood Park* case in *Continental Securities Co.* v. *Belmont*, 168 App. Div. 483, 490 (2d Dept. 1915) aff'd 222 N. Y. 673 (1918).

> spects as well that case and the present bear a striking similarity." (Emphasis ours.)

In an attempt to lend some color to the contention that "federal", and not state law was applied, the petition omits from a quotation from the District Court's opinion (Pet., p. 13, n. 6) the following highly significant passage which makes it clear that the District Judge applied the law of New York (R. 1238-9):

> "In *Blum* v. *Whitney,* 185 N. Y. 232, the New York Court of Appeals laid down the rule that where all those in interest have knowledge of the facts no wrong has been done the corporation. This appears to still be the law of New York. See, *Goldstein* v. *Tri-Continental Corp.* (Sup. Ct., N. Y. Co., 1940), N. Y. L. J., December 19, 1940, p. 2116."

3. There is No Basis for Granting a Writ of Certiorari in this Case.

The petition does not show that the court below "decided an important question of local law in a way probably in conflict with applicable local decisions."

A reversal of the Circuit Court of Appeals decision that this suit is barred by the New York ten-year statute of limitations and of the District Court's dismissal on the merits would require this Court to overrule the detailed and specific Findings of Fact made by the District Court (see *supra,* pp. 5-6 and 9-10) to the effect that there was no fraud or conspiracy and that the Bank did not participate in any wrongdoing. The summary of the facts made by the Circuit Court of Appeals in its opinion indicates clearly its agreement with these basic Findings of Fact (R. 1275, 1278, 1279). The petition should therefore be rejected because in effect it requests this Court to set aside

concurrent Findings by two courts below, in a situation where no conflict of decision among Circuit Courts of Appeal exists or could exist. Cf. *Goodyear Tire & Rubber Co., Inc.*, v. *Ray-O-Vac Co.*, 321 U. S. 275, 278 (1944).

Conclusion.

The courts below correctly applied the law of New York, both as to the statute of limitations and on the merits. The petition raises no question of general importance, and should accordingly be denied.

Dated, December 2, 1947.

Respectfully submitted,

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FILE COPY

Supreme Court of the United States

OCTOBER TERM, 1947

No. 449

JOHN A. LAIRD, *Petitioner*,

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF INDIVIDUAL RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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THE COURT PRESS, N. Y. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 440

JOHN A. LAIRD, *Petitioner,*

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF INDIVIDUAL RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Opinions Below.

The Opinion of the District Court (R. 1230-1250) is unreported. The Opinion of the Circuit Court of Appeals is reported at 163 F. (2d) 12.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered August 13, 1947 (R. 1280). The petition for a writ of certiorari was filed November 13, 1947 and served November 14, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Preliminary Statement.

This is a derivative suit on behalf of United Shipyards, Inc., begun on September 18, 1940, more than 10 years after the acts complained of, which occurred in February, 1929.

After trial, the District Court found no fraud, breach of fiduciary obligation, or overreaching by any defendant, no damage to the corporation, and further that the alleged cause of action accrued more than 10 years before suit (fols. 3775, 3776, 3797, 3799, 3800).

The Circuit Court of Appeals affirmed all the facts found below.

The only question of law which the Circuit Court of Appeals deemed necessary to mention was that under *Guaranty Trust Co.* v. *York,* 326 U. S. 99, the cause of action was barred under controlling New York law.

Petition Misstates Questions Involved.

The only question presented by this writ is whether the Circuit Court of Appeals misconstrued the controlling New York decisions interpreting its Statute of Limitations, but—

Petitioner cites no case to support any contention that the Court below "decided an important question of local law in a way probably in conflict with applicable local decisions" (Rule XXXVIII, subd. 5 [b]).

The only question of law decided by the Circuit Court of Appeals was that under the controlling New York State law the suit was barred by the 10-Year

New York Statute of Limitations (N. Y. Civ. Prac. Act, Sec. 53), and that accrual was not postponed until discovery by Section 48(5) of the New York Civil Practice Act. The District Court had decided the case on the facts in favor of defendants under the controlling state law, and had also decided that under state law the cause of action had in fact accrued more than ten years before suit (fol. 3775), but did not pass on the applicable statute of limitations because the appeal in *Guaranty Trust Co.* v. *York,* 326 U. S. 99 was then pending undecided.

The petition misstates the holdings below when it asserts that the lower courts held anything "under the 'federal' rule" (p. 1).

No question is presented as to whether "a federal court may in a diversity suit ignore state law" (p. 2).

Decision Below Correct.

The decision below that the New York statute was a bar was correct.

The affirmance could have been justified solely on the findings of fact of the District Court, many of which are recited in the opinion of affirmance. No questions of law such as are tendered by petitioner survived these findings of fact.

In any event, the questions of law mentioned in the opinion of the District Court were correctly resolved under the controlling New York law, even though unnecessary to the decision after *Guaranty Trust Co.* v. *York,* 326 U. S. 99, as the Circuit Court of Appeals concluded.

Affirmance Solely on Ground That the Controlling New York Statutes of Limitation Were a Bar.

As appears from the opinion of the Circuit Court of Appeals, its affirmance was predicated solely on its construction of the New York Statute of Limitations (p. 1279):

> "We find it unnecessary to set forth in greater detail either the facts found or the claims made by the respective parties for in our opinion the New York statute of limitations is a bar to the suit.
>
> * * * *
>
> It may be that the trial judge did not base his decision upon this ground because *Guaranty Trust Co.* v. *York,* 326 U. S. 99 had not then been decided. That case now shows conclusively that the New York statute of limitations does apply. That statute, as construed by the New York courts, had run before this suit was brought."

The only question, therefore, which petitioner may raise as a ground for certiorari is whether the Court of Appeals erred in its holding that the New York statute "as construed by the New York Courts, had run before this suit was brought."

Nowhere does petitioner cite a New York case which holds (or even suggests by dictum) that the New York statute does not bar any corporate claim on the facts here involved.*

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* Curiously enough, petitioner's only reference to New York cases construing the New York Statute of Limitations is found in a footnote (9) on page 15 and in the one page Appendix III on page 23.

New York Cases Construing New York Statutes Correctly Interpreted.

The *ratio decidendi* below was:

> "There was no allegation or proof of fraud—of the kind which is found in *Reno* v. *Bull,* 226 N. Y. 546, 550. Such fraud must necessarily be pleaded and proved to establish a cause of action on which, by virtue of Sec. 48 (5) of the Civil Practice Act, the statute does not begin to run until discovery. *Hastings* v. *Byllesby & Co.,* 293 N. Y. 404."

That such fraud must necessarily be pleaded and proved to delay accrual until discovery has recently been restated in *American Cities Power & Light Corp.* v. *Williams,* 69 N. Y. S. 2d 197, 202:

> "In order to bring the case within Section 48 (5) of the Civil Practice Act the allegations must be sufficient to charge fraud and deceit with all the elements present, as outlined in the leading case of *Reno* v. *Bull* (226 N. Y. 546)."

Reno v. *Bull,* 226 N. Y. 546, required that the person asserting the cause of action—here the corporation—had relied on a false representation and that such person—here the corporation—had relied thereon to its injury.

Here, admittedly, any representation claimed to have been false was made by the corporation itself to prospective purchasers of its stock thereafter to be marketed, and hence could not have been relied on by the corporation to its injury upon its organization.

We annex as an Appendix our argument below on the Statute of Limitations (p. 11, *infra*).

There Were No Facts Such as Are Necessary to Postpone Accrual Under New York Law and the Findings Negative Any Such Facts.

There was, however, no false representation. The only representation claimed (Petition, p. 3) is that the prospectus "made it appear that options on the six properties were held by United and that the aggregate price of $20,090,000 in cash and securities was to go to the named vendors."

Neither Court below found any representation to have been false.

The District Court found (II, pp. 1266-1267) that "None of the defendants * * * conspired to defraud or injure United or any of its stockholders, present or prospective" and that "The transactions complained of were openly and fairly made for the benefit of its stockholders. There was no fraud or concealment."

These findings were not reversed by the Circuit Court of Appeals.

The only alleged misrepresentation in the prospectus was the statement that "options or agreements to purchase these properties have been secured for" certain stated cash, mortgages and securities which included the 4,400 shares of preferred, concerning which petitioner complained. The options had in fact been secured for United, recited that they had been secured for a corporation to be formed (fols. 1954, 1853, 1910, 1928, 1940), were alleged in the amended complaint to have belonged to United (I, pp. 46.20) and were admittedly exercised by United.

There was therefore no misrepresentation.

Nor could the corporation have relied on any prospectus misrepresentation, had any been made, since the corporation drew up and issued the prospectus, and did not rely on it in issuing the 4,400 shares of preferred. They were issued in order to acquire shipyard properties which the corporation could not otherwise have acquired, as we next show.

On the Merits, the District Court's Unreversed Findings of Fact Are That There Was No Profit to Defendants or Injury to the Corporation.

There was not even a profit, much less any secret profit.

The District Court found that the 4,400 shares of preferred "were issued in good faith and for a good, valid and valuable consideration" (II, p. 1258). Powell and Rogers acquired these shares in return for purchasing for $1,700,000 cash, purchase money mortgages which the corporation had given in order to acquire the Shewan and Crane shipyard properties. When the Shewan and Crane interests refused to accept mortgages instead of cash and the corporation had insufficient funds to pay cash, Powell and Rogers advanced $1,700,000 for these mortgages and the 4,400 shares of preferred, both of which they intended to resell in a package for $1,700,000 (fols. 287, 226, 228). Their hopes were foiled by subsequent events and they unwillingly found themselves holding the bag for almost ten years.

The District Court found (II, p. 1258):

"36. At the time of acquisition of the Shewan mortgage and the interest in the Crane mortgage

> by defendants, Rogers and Powell, there was no profit to said purchasers at the expense of United or at the expense of anyone then interested or about to become interested in United. * * *
>
> "38. Defendants, Powell and Rogers, realized no secret profit as a result of the Shewan and Crane transactions, and the acts of Rogers and Powell in connection with the Crane and Shewan transactions were carried on in good faith."

In affirming, Chase, *Ct. J.*, quoted these findings (p. 1278) after observing that:

> "These purchases were made, after fruitless attempts to find other purchasers, to enable United to take up the options."

Questions Considered by the District Court, but Not Decided by Circuit Court of Appeals.

(a) Whether under the facts found New York law gave the corporation any cause of action.

The District Court found as a matter of fact that "None of the defendants cheated or defrauded United", that none of them "conspired to defraud or injure United" (II, p. 1266). "The transactions complained of were openly and fairly made for the benefit of its stockholders. There was no fraud or concealment" (II, p. 1267), that defendants "realized no secret profit as a result of the Shewan and Crane transactions" (II, p. 1259) and that "At the time * * * there was no profit to said" defendants "at the expense of United or at the expense of anyone interested or about to become interested in United" (II, p. 1258).

In its opinion, the District Court considered whether, under these facts, including the charter provision which permitted defendants to deal with the company in the absence of fraud (Ex. 9, p. 630), the corporation could have any cause of action under New York law.

It concluded that under the circumstances the assent of all the then shareholders barred the corporation under the controlling New York law, citing *Blum* v. *Whitney,* 185 N. Y. 232 (II, p. 1239), especially since in the absence of fraud its promoters were authorized by its charter to deal with the corporation, citing *Everett* v. *Phillips,* 288 N. Y. 227 (II, p. 1243).

We urged on appeal that there was no recoverable damage or profit under the controlling New York law; or for that matter under any law where as here there was no factual proof of fraud, and charter authorization to deal with the corporation.

The Circuit Court of Appeals elaborately stated the facts and pertinent findings below, but found it unnecessary to pass on these questions of law argued.

(b) Whether the final order in the 77-B proceeding prevented the corporation from asserting a claim arising out of the Crane and Shewan transaction.

The 4,400 shares of preferred in question were exchanged as part of an elaborate compromise effected in 77-B many years later, for shares in the reorganized company. The District Court held as a matter of federal law that this was a valid defense.

On appeal, we urged the correctness of this holding, (1) as a *res adjudicata* and estoppel by judgment, (2) because thereafter any alleged profit was the result of ownership under court order, not of breach of fiduciary duty, and (3) because the corporation was estopped by that compromise to assert alleged rights then already almost ten years old.

The Circuit Court of Appeals did not pass upon this defense, merely mentioning in passing that the shares had been exchanged in a 77-B proceeding and that "After the reorganization and the outbreak of World War II a good sale of all the properties of the reorganized corporation was made and the amount thus realized doubtless became the financial incentive for bringing this suit."

Since the Circuit Court of Appeals never passed on this defense, there is no point in making the argument here.

CONCLUSION.

The petition for certiorari should be denied.

Dated, December 2, 1947.

Respectfully submitted,

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Appendix.

"POINT IV.

The cause of action is barred by the Statutes of Limitation.

A.

The New York Statutes of Limitation govern both the time of accrual and time within which suit at law or in equity must be brought.

Guaranty Trust Co. v. *York* (1945), 326 U. S. 99;
West v. *A. T. & T. Co.* (1940), 311 U. S. 223, 236;
Fidelity Trust Co. v. *Field* (1940), 311 U. S. 169, 178;
Stoner v. *N. Y. Life Ins. Co.* (1940), 311 U. S. 464, 467.

B.

Under New York law, any cause of action accrued at the time of such transactions.

Whatever may be the rule in some other jurisdictions, the courts of New York have steadfastly refused for over a century to permit the judiciary to graft additional exceptions on the controlling statutory periods of limitations. The remark of Spencer, *Ch. J.*, in 1822 in *Troup* v. *Smith's Ex'rs*, 20 Johns. 33, 47, is equally true today:

> '* * * I know of no dispensing power which courts of law possess, arising from any cause whatever * * *.'

Many of the subsequent cases reiterating this principle and applying it to a wide variety of situations are collected in *Turner* v. *American Metal Co.*, 36 N. Y. S. (2d) at 379.

Control of the corporation by the alleged wrongdoers does not toll the applicable statute.

Zwerdling v. *Bent* (1943), 291 N. Y. 654;
Lever v. *Guaranty Trust Co.* (1942), 289 N. Y. 615;
Pollack v. *Warner Bros. Pictures Inc.* (1943), 266 App. Div. 118, 120.

In the *Zwerdling* case, 'The appellant [unsuccessfully] urged in the Court of Appeals, among other things, that * * * the action was not barred until relinquishment of control by the directors alleged to be delinquent and to constitute a majority of the board' (291 N. Y. at 655). In the *Lever* case, the same claim was advanced again unsuccessfully against a motion directed to the complaint which alleged that defendants 'possessed and exercised, during such entire ten-year period, substantially complete control and domination of the board of directors' (289 N. Y. at 617). In the *Pollack* case, the Court said the statute ran 'regardless * * * of the continuance in control by appellants' (266 App. Div. at 120).*

(1) *Accrual was not postponed until discovery.*

A cause of action in a derivative suit to recover from a director profits improperly made at the expense of his corporation on the sale to it of property (*Hastings* v. *Byllesby & Co.* [Haystone] (1944), 293 N. Y. 404; *Teich* v. *Lawrence* (1943), 291 N. Y. 245; *Lever* v. *Guaranty Trust Co.* (1942), 289 N. Y. 615; *Gobel, Inc.* v. *Hammerslough* (1941), 288 N. Y. 653) accrues at the time of the sale and not at the time of 'discovery'.

In *Teich* v. *Lawrence* (1943), 291 N. Y. 245, the Appellate Division did not dismiss the first cause of action as barred by the statute because 'The action is for actual fraud, in that respondents participated in a scheme

* Others *ad infinitum* could be mentioned by reference to the cases on appeal. The proposition is so obvious to the New York minority stockholders' bar that it is usually not urged and the New York courts do not bother to discuss it. Indeed, an overwhelming majority of such suits allege, as an excuse for failure to demand that the corporation bring suit, domination and control by the wrongdoers.

wherein certain stock was sold to [the nominal defendant] the Equity Corporation's subsidiary for a grossly inflated price, the proceeds of which sale were paid through respondents' corporations to the majority stockholder of the Equity Corporation, and in return for all of which respondents obtained the stock which gave them control of the Equity Corporation. * * * the transaction was an actual fraud and nothing else, and the time for bringing an action thereon began to run from the date of the discovery of the fraud * * *' (265 App. Div. 974, 975). The Court of Appeals reversed and dismissed this cause of action as barred, saying *per curiam* (p. 249):

> 'This was error. A stockholders' derivative action belongs to the corporation that has been wronged. The present complaint alleged no fraud upon the defendant corporation in whose behalf the plaintiffs sue. (See *Lever* v. *Guaranty Trust Co.*, 289 N. Y. 615.)'

In *Hastings* v. *Byllesby & Co.* [Haystone] (1944), 293 N. Y. 404, the 16th cause of action alleged a 'corrupt and fraudulent conspiracy * * * to obtain large profits and substantial personal benefits at the expense of the debtor corporation' which was consummated by the conspirators receiving from the corporation 'valuable stock in subsidiary corporations and large sums of money in exchange for stock which had cost' the conspirators 'much less', one of the conspirators selling 'some of the stock thus received for $25,000,000' (p. 408). In affirming the dismissal as barred by the Statute, Lehman, *Ch. J.*, wrote (p. 411):

> 'The allegations of the complaint that the defendants conspired to secure "fraudulent" profits and acted in "fraud" of the corporation * * *even if accepted as allegations of fact * * * are only incidental to the cause of action brought against the defendants on the ground that they have disregarded their duty to the corporation. Such allegations do

not constitute a cause of action "to procure a judgment on the ground of fraud" which, under the provisions of section 48, subdivision 5, of the Civil Practice Act, "is not deemed to have accrued until the discovery * * * of the facts constituting the fraud". *Gobel, Inc.* v. *Hammerslough*, 263 App. Div. 1, affd. 288 N. Y. 653; *Dunlop's Sons, Inc.* v. *Spurr*, 285 N. Y. 333.)'

An example of when Section 48, subdivision 5, applies even though a fiduciary duty has also been violated is *Mannaberg* v. *Klausner* (1945), 294 N. Y. 859. There '"The complaint contains allegations sufficient to sustain a cause of action for fraud in that by *false representations* the plaintiff was *induced to consent to the sale of an asset of the partnership*. To such a cause of action the six-year Statute of Limitations would apply only from the date of discovery of the fraud (Civ. Prac. Act, Sec. 48, subd. 5) even when the fraud is practiced by a partner upon another member of the partnership"' (p. 860).

But to bring his corporate cause of action within the discovery section, plaintiff must prove as to the corporation all the elements of the classic fraud case of *Reno* v. *Bull* (1919), 226 N. Y. 546, 550. It is vital that the fraud relied on be the *inducement to the company's* act from which *the damage flowed*.

Here the corporation knew that Powell and Rogers were interested in the Crane and Shewan transactions and that without their aid it could not acquire said properties.

Moreover, the complaint here seeks solely the recovery of alleged profits (fols. 37, 38, 40, 137.27, 138.36, 137.40).

But in an action for fraud, 'All elements of profit are excluded' (*Reno* v. *Bull* [1919], 226 N. Y. 546, 553).

There is not even proof of overvaluation in the issuance of securities (pp. 14-17, *supra*) which if gross enough, is

sometimes loosely characterized as a fraud when the 'discovery' section of the Statute is not at issue.

In a very recent case, *American Cities Power & Light Corp.* v. *Williams*, not yet officially reported,* recovery was sought against the dominating director and a company of which he owned a majority of the stock for profits allegedly made by him and said company at the expense of plaintiff corporation. In dismissing causes of action as barred by the Statute, Mr. Justice Shientag reviewed at length the existing state of New York law with respect to so-called 'fraud' actions under Section 48 (5):

> 'Here, in essence, the wrong charged was breach of fiduciary duty in the waste of corporate funds. The charge that the breach was fraudulent does not operate to change the essential character of the wrong claimed.
>
> In order to bring the case within Section 48 (5) of the Civil Practice Act the allegations must be sufficient to charge fraud and deceit with all the elements present, as outlined in the leading case of *Reno* v. *Bull* (226 N. Y. 546).
>
> I can find no allegations of fraud other than the matters cited relating to failure to disclose to the corporation. It is conceded on the argument, however, that all of the directors of the corporation were quite aware at all times of the transactions which were taking place and there is no allegation that the directors were misinformed or ignorant of the facts when they acted. The corporation is therefore chargeable with notice and no cause of action for non-disclosure is pleaded unless we adopt plaintiffs' argument that there should have been a disclosure to the stockholders, members of the public who had no chance to discover the facts.
>
> * * * *
>
> Referring further to the contention of plaintiffs

* Now reported in 69 N. Y. S. (2d) 197, 202, 204

that the six causes of action are protected because of failure to disclose the facts to the stockholders and that, therefore, section 48 (5) of the Civil Practice Act applies, I am unable to find any decisions which hold to that effect. Once it is conceded that at the time the action was taken by Williams the other directors knew what was being done, it seems clear that the corporation is chargeable with such knowledge. In such a situation the only people from whom it may be said that there has been a concealment are the general class of innocent, uninformed stockholders. This does not give a cause of action under section 48 (5) many years later, when the innocent stockholders discover the facts. This was decided by the Court of Appeals in *Lever* v. *Guaranty Trust Co.* (289 N. Y. 615). There the court made an order dismissing the complaint, which alleged that the damaging facts had never been disclosed and were still unknown to the stockholders generally and that the plaintiff stockholder first discovered the existence of the facts during the year in which he brought suit. In *Teich* v. *Lawrence* (291 N. Y. 245), a similar claim of concealment from stockholders was made. The Court of Appeals cited the decision in the *Lever* case with approval, saying: "A stockholder's derivative action belongs to the corporation that has been wronged. The present complaint alleged no fraud upon the defendant corporation in whose behalf plaintiff sued."'

There is nothing here even remotely resembling 'an action to procure a judgment on the ground of fraud' within the meaning of Section 48 (5).

(2) *No new cause of action accrues if later the mala fide fiduciary reaps additional profit by selling the property or investing the funds which he had wrongfully acquired.*

Equity Corp. v. *Groves* (1945), 294 N. Y. 8;

Hastings v. *Byllesby & Co.* [Haystone] (1944), 293 N. Y. 404.

The Court below correctly found that any claim based on the Crane and Shewan transactions accrued on or prior to February 28, 1929 (Finding No. 83, fol. 3800).

It made no conclusion of law as to the statute presumably because it was either unnecessary or inadvisable since the *York* case had not then been decided by the Supreme Court.

C.

Under New York law the Shewan and Crane causes of action were barred because they accrued more than ten years before suit was begun.

The Shewan and Crane transactions occurred early in 1929 (Findings Nos. 34-37, fol. 3773). Suit was begun in September 1940 (Finding No. 82, fol. 3800), more than ten years after accrual of any cause of action (Finding No. 38, fol. 3775). Any claim based thereon is therefore in any event barred by the ten-year statute (N. Y. Civ. Prac. Act., Sec. 53).

D.

In any event, the claims are barred by 'discovery' within the meaning of Section 48 (5) more than six years before suit.

But even if Section 48 (5) applied, the claim would be barred since there was 'discovery' within the meaning of that subdivision more than six years before suit was begun. Suit was begun on September 18, 1940. Six years before that United was already in 77-B reorganization (Exs. J-I, 02, pp. 1011, 1025) where all claimants and security holders had access to its Minute books. The Minutes of January 18, 1929 set forth in full for all who chose to read the very same facts from which plaintiff seeks to infer a 'secret profit' (Ex. 13-C, pp. 769-776).

Under New York law, plaintiff must prove that United did not discover facts sufficient to put it upon inquiry* more than six years before the commencement of suit (*Mason* v. *Henry*, 152 N. Y. 529 at 539).

No such proof was adduced. The majority of the Board was independent from March 6, 1929 (p. 26, *supra*),—certainly from April 3, 1929 (p. 27, *supra*). Such evidence as there is indicates their knowledge. There is no finding that they were dominated or controlled (cf. *Michelson* v. *Penney*,† 135 F. 2d 409, 415-416),—finding 80 necessarily implies no domination or control (p. 1266),—or that they were ignorant of facts sufficient to put them upon inquiry. The claim is therefore barred even under the 'discovery' section."

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* As to what constitutes facts sufficient to put it upon inquiry, *i. e.*, 'discovery', see:

Klotz v. *Angle*, 220 N. Y. 347, 360, 361;
Higgins v. *Crouse*, 147 N. Y. 411, 415.

† That domination and control does not toll the New York Statute is clear from the cases heretofore cited, decided after *Michelson* v. *Penney*.